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SUBJECT: ECONOMIC CHALLENGES FACING MOROCCO'S NEW GOVERNMENT

REF: A. RABAT 1525

[1](#)B. RABAT 1223

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[1](#)1. (SBU) Summary: Incoming Prime Minister Abbas El Fassi will take charge this month of an economy that has performed well over the last five years. He follows in the footsteps of a Prime Minister who is generally regarded as having been one of the strongest in Morocco's history, and whose business experience gave him particular credibility with the Moroccan business and financial community. The Jettou government, with a range of projects and initiatives, and a favorable international climate, was successful in boosting Morocco's annual GDP growth above its historic average over that of previous decades and in ensuring that non-agricultural growth stayed strong even in years when agriculture faltered. Significant challenges remain, however, to ensure that higher growth is sustained over the long term, and to extend its benefits to all Moroccans. These include continued serious shortcomings in the moribund Moroccan educational system, a fiscal and social security regime that has sapped the competitiveness of Moroccan exports, and endemic corruption, particularly in the judiciary. In his valedictory address, Jettou forthrightly admitted that his government was less successful in some of these areas than he would have wished, and Fassi's initial comments (as well as the King's Throne Day speech) make clear that Morocco's social deficit will be the new government's primary focus. Less evident is whether the parties that make up the governing coalition will make good on their promises to reform Morocco's tangled fiscal regime. End Summary.

[1](#)2. (SBU) A tough act to follow: The general consensus in Morocco is that incoming Prime Minister Abbas El Fassi has big shoes to fill. Prime Minister Jettou's tenure is viewed as one of the most successful in Morocco's history, and he is credited with imparting a new dynamism and vigor to the Moroccan economy. Growth in real GDP has averaged 5.4 percent since 2001, despite several years of drought, exports have increased more than 10 percent a year, while foreign direct investment (FDI) has increased rapidly, reaching between three and four percent of GDP annually (twice its level at the start of the decade). The economy created 300,000 jobs in 2006, double the average of preceding years. The confidence that the outgoing administration engendered

(admittedly coupled with a positive international environment) was evident not just in increased FDI, but in the flow of transfers from Moroccans abroad, which together with tourism revenues has kept Morocco's current account in surplus, even as import growth has outstripped that of exports.

¶3. (SBU) But gaps remain, arguably in areas that will be even more difficult to address, as they are structural and deeply entrenched. Jettou and his team's particular focus was on the "grands chantiers," or large scale projects that have started to transform Morocco. These include the new container port at Tangier Med and its neighboring free trade zones, the Bouregreg Valley project in Rabat, and the five mega-tourism projects that constitute the Plan Azur. The government also worked hard to sell Morocco to foreign investors, through sectoral initiatives targeting offshoring, auto parts, aviation, and other sectors. High profile investments such as Renault's decision to open a 5 billion USD plant in Tangier and Procter and Gamble's decision to make Morocco the hub of its regional operations highlight the government's ability to structure deals that could entice large investors to the country. Less successful, however, were the government's attempts to transform the business environment in Morocco and to remove structural factors that impede business expansion. Morocco continues to languish in the lower tier in "doing business" ratings put out by both the World Bank and the World Economic Forum.

¶4. (SBU) Education: One key issue highlighted both by those studies and virtually all observers is that of education. The Moroccan education system is widely perceived to be broken, and to fail to produce the skilled workforce that will enable Morocco to compete in the world economy. In a

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meeting in Casablanca, one furniture manufacturer recently complained to us that he has been obliged to create "at considerable expense" his own training institute for company salespeople, as he is unable to find personnel who have the requisite language and sales skills. He stressed that the positions he is filling are hardly those of specialized engineers, but even finding graduates with adequate French-language skills is difficult. Observers point to the fact that there has never been a clear strategy for reform of education, and that the system continues to lack resources, with the result that teachers are unmotivated and absenteeism is high. (Note: Fassi's Istiqlal party is widely saddled with the blame for mismanaging the education portfolio it held in the 1980's and 1990's, exemplified by an ill-planned Arabization initiative that had chaotic results. End note.)

¶5. (SBU) Fiscal issues: Another structural problem is Morocco's fiscal regime, which weighs heavily on the competitiveness of Moroccan companies. With a narrow tax base (speakers at a recent colloquium in Rabat noted that only 50 companies pay half of all company taxes in the country), rates are extremely high. Karim Tazi, former head of the textile industry association, argued to us in a recent meeting that the entire Moroccan fiscal and customs system is skewed against Moroccan industry, and that it must be reformed if that industry is to survive completion of free trade with Europe in 2012. He argued that for small and medium-sized enterprises, company (or profit) taxes, which have been the focus of most Moroccan party programs, are not the problem. Such companies barely make profits, he argued, as they are weighed down by high upstream taxes on income (which are borne by the employer, as employees negotiate a "net" salary) and local taxes. The result has been a flight from the formal sector to the informal sector.

¶6. (SBU) Morocco's tenuous budgetary situation, and persistent deficits, however, make this a difficult issue for any government to address. While the overall government debt to GDP ratio and budget balance have improved over the last five years, budgetary pressures this year will not leave

Fassi much room to maneuver. Increased subsidies for basic commodities and fuel, as well as abolition of duties for wheat, milk and other products will worsen this year's budget balance.

¶17. (SBU) Trade Policy: Critics blame not just fiscal policy for Moroccan industry's lack of competitiveness, however. They cite shortcomings in Moroccan trade policy as well, noting that while duties have come down on finished products as a result of Morocco's numerous free trade agreements (including with the U.S.), many inputs remain subject to high protective tariffs. Thus Tazi, who operates in the furniture sector as well as textiles, noted that his attempt to supply Morocco's large furniture chains (Ikea imitators Mobilia and Kitea) foundered when he found that the cost after duty of imported composite material exceeded the price of finished imported products. Producers in other sectors have had similar experiences. Morocco continues to protect producers of sugar, for instance, so that domestic candy and biscuit makers have had difficulty competing with cheap imports from Turkey and Tunisia. Only the recent rapid rise in international commodity prices has started to cushion the impact of this disadvantage.

¶18. (SBU) Trade Gap: The net result of these shortcomings has been that while Moroccan exports have grown over the last five years, their rate of growth is slowing, and the export coverage ratio for imports continues to decline. This year it fell below 50 percent for the first time. As IMF experts told the government in this year's Article IV consultations, action on competitiveness is essential to ensure that the external sector emerges alongside domestic demand as a "second growth engine."

¶19. (SBU) Judicial corruption: Beyond trade competitiveness, additional structural issues surround the troubled Moroccan judiciary, which operates lethargically, and is widely perceived to be riddled with corruption. Seasoned observers of the Moroccan scene tell us that money plays a key role in many decisions, though of course they are reluctant to cite specifics. Our own experience with small and medium-sized

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American investors is that whether or not the process is corrupt, it rarely comes to closure in a timely fashion, and judgments are often not enforced. Instead, the losing party files suit again-- either an appeal or a new case-- and puts off the day of reckoning. One bankrupt American company that experienced difficulties with a Moroccan partner is still in court, years after it won a series of initial judgments.

¶10. (SBU) Agriculture: Another long neglected area is that of agriculture, a sector that accounts for 15 to 20 percent of GDP, but continues to employ 40 percent of the nation's workforce. How to modernize and strengthen the sector in the face of climatic changes is a key challenge that previous governments have shied away from addressing. Moroccan agriculture is overly specialized in grains (as a result of government price supports), is generally composed of small uneconomic production units (75 percent are less than 12 acres), and suffers from weaknesses including lack of research and development, weak marketing infrastructure and absence of market information. No Moroccan government has yet been able to balance the conflicting goals of modernizing the sector through economies of scale and capital investment while also alleviating poverty and maintaining the social structure of traditional rural society. (Note: A start will be made in coming years through the new U.S.-Morocco MCC Compact, however, as MCC will invest some 300 million USD to modernize segments of the fruit tree sector, and encourage farmers in marginal areas to move away from cereal crops. End note.)

¶11. (SBU) Growing disparities: A final, and key, concern is how equitably Morocco's recent success has been shared through the economy. Income inequality appears to be growing

rapidly, though precise statistics are hard to come by. Certainly, dramatic new wealth is evident in Morocco's major metropolis, Casablanca, and is also apparent in the exploding cost of real estate. The broad mass of the population has not shared in these gains, however. Many civil servants and other middle income workers find themselves priced out of Morocco's cities, while worker incomes have stagnated, and new employment, while impressive, has not kept pace with new entrants to the labor force. The head of one respected think tank told us he attributes much of the voter apathy that was evident on September 7 to the public's belief that government policy has brought it little benefit. The "working poor," he argued, constitute 3/4's of Morocco's population and the outgoing government's record was mixed on their key concerns of employment, education and health. Recent riots over rising prices for basic commodities (reftel), as well as the palpable anger Emboffs found during regional election trips in some economically disenfranchised parts of Morocco show that the margin of social stability is narrow in some areas, and that sharing the benefits of growth more widely must be a high priority.

¶12. (SBU) Comment: The incoming Prime Minister appears to be cognizant of this social deficit. His initial comments to the media after he was entrusted with forming a new government focused exclusively on social issues, a fact that did not escape public comment here. Observers also found significant King Mohammed VI's call for urgent action to address shortcomings in the Moroccan educational and judicial system in his July throne speech. A number of contacts observe that this is the first time in their memory that a Moroccan monarch had spotlighted these problems. Longer range, some action is likely to mitigate the impact of Morocco's fiscal regime, given the fact that most parties supported such action in their electoral programs. Concern about the impact on public finances will probably preclude a dramatic cut in tax rates, however. Other priorities such as agricultural reform, will likely continue to languish, given the range of other pressing problems. In sum, Jettou has left the Moroccan economy in solid shape, but it remains fragile, and does not leave the incoming government an opportunity to rest on the laurels of past successes. End Comment.

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